

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
REAL ART PLASTIC & METAL CO. }

For Appellant: Edward J. Eng  
Attorney at Law

For Respondent: Crawford H. Thomas  
Chief Counsel

Marvin J. Halpern  
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Real Art Plastic & Metal Co. against proposed assessments of additional franchise tax in the amounts of \$1,150.83, \$1,068.44, \$2,396.82, and \$764.96 for the income years ended June 30, 1966, 1967, 1968, and 1969, respectively.

Appellant, a California corporation, was incorporated on July 17, 1957. Its principal business activity involves fabricating plastic, machining metal, and

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assembling components. Two corporate officers each own 50 percent of appellant's stock. As a condition to obtaining a Small Business Administration (SBA) guaranteed loan, appellant had to obtain life insurance policies on the lives of its two shareholder-officers, who were required to guarantee the loan. The insurance policies named appellant as the beneficiary; however, the policies were assigned to the SBA as additional collateral for the loan. The premiums which appellant paid on the policies were deducted from income during the years in question. Respondent disallowed the deductions and proposed additional assessments. The proposed assessments were protested by appellant. Respondent's denial of the protests gave rise to this appeal.

The sole issue for determination is whether the premiums paid by appellant on life insurance covering the lives of its two officers are deductible business expenses when appellant is the beneficiary.

Section 24424, subdivision (a)(1), of the Revenue and Taxation Code provides:

- (a) No. deduction shall be allowed for--
- (1) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

The above provision is identical to section 264(a)(1) of the Internal Revenue Code of 1954.

The Internal Revenue Service, in interpreting section 264(a)(1), has ruled that where one of the conditions of an SBA loan is that a corporate borrower assign policies of life insurance on the lives of its officers to the SBA, the corporation is an indirect beneficiary of the Policies and the premiums paid on the policies by the corporation are not deductible. (Rev. Rul. 68-5, 1968-1 Cum. Bull. 99.)

In Dwight E. Hanson, T.C. Memo., Jan. 20, 1970, a matter quite similar to the present appeal, the taxpayer was required to assign a life insurance policy on his life to the bank as a condition of obtaining an SBA loan. In

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Hanson the court held that, although the premiums would otherwise be deductible as a business expense, since the taxpayer was an indirect beneficiary of the policy the premiums were not deductible. (Accord, Roy H. King, T.C. Memo., Sept. 27, 1963.) In reaching this conclusion the court noted that the taxpayer benefited in many ways. The assignment of the policy allowed him to receive the needed loan, and the policy served as collateral security for the loan. In the event of his death the proceeds would be used to discharge the indebtedness, thereby indirectly augmenting his estate by eliminating a claim against it. Finally, when the loan was extinguished the policy would be returned to him, and he would then possess all the ownership rights in the policy, including the rights to designate the beneficiary, to borrow against the policy, and to surrender the policy for its cash value.

In the instant matter appellant not only is indirectly benefited by the policies for reasons similar to those announced in the Hanson decision but also is directly benefited since it is the named beneficiary under the terms of the policies.

Appellant, in support of its position, has relied upon two rulings, O.D. 1109, 5 Cum. Bull. 177 (1921); and G.C.M. 8432, IX-2 Cum. Bull. 114 (1930). Both of those rulings have been declared obsolete, the former by Rev. Rul. 68-575, 1968-2 Cum. Bull. 603, and the latter by Rev. Rul. 68-674, 1968-2 Cum. Bull. 609.

Consequently, it is our conclusion that the premiums paid by appellant on life insurance covering the lives of its two officers are not deductible where appellant is the named beneficiary. Therefore, respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED,,  
pursuant to section 25667 of the Revenue and Taxation Code,  
that the action of the Franchise Tax Board on the protest  
of Real Art Plastic & Metal Co. against proposed assessments  
of additional franchise tax in the amounts of \$1,150.83,  
\$1,068.44, \$2,396.82, and \$764.96 for the Income years  
ended June 30, 1966, 1967, 1968, and 1969, respectively,  
be and the same is hereby sustained.

Done at Sacramento, California, this 27th day  
of March, 1973, by the State Board of Equalization,

*J. Charles Lee*, Chairman  
*John W. Lynch*, Member  
*Bob [unclear]*, Member  
*Paul [unclear]*, Member  
\_\_\_\_\_, Member

ATTEST: *W. W. Dimple*, Secretary